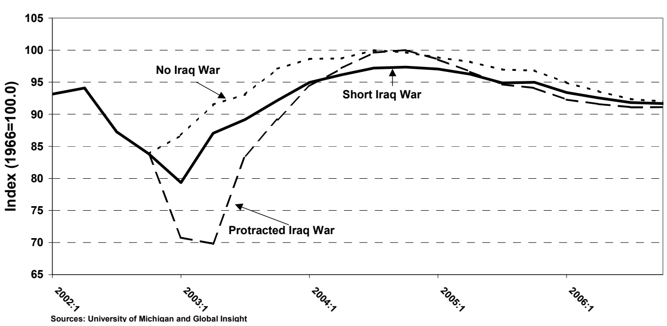
IDAHO OUTLOOK

NEWS OF IDAHO'S ECONOMY AND BUDGET

STATE OF IDAHO **DIVISION OF FINANCIAL MANAGEMENT** **JANUARY 2003 VOLUME XXIV NO. 07**

Few things scare consumers like uncertainty. One of the current uncertainties facing our nation is whether we will go to war against Iraq. In recent weeks, the level of saber rattling has escalated, causing the odds of a conflict in the Middle East to rise. This war will impact the economy. In fact, even before the first shot has been fired, it is already impacting the economy. Fears caused by war tensions are already affecting consumer behavior. This has contributed to the decline in consumer confidence in the last two months. Experts are attempting to quantify these impacts. For example, the costs of this war are already being debated. However, this is not the sole impact of the conflict; this war will have ripple effects will be felt throughout the economy.

Consumer Sentiment Index



Global Insight has prepared three alternative scenarios to assess the impact a war with Iraq will have on the national economy. The baseline scenario assumes the U.S. and Iraq will go to war, but, as in the previous Gulf War, the U.S. will achieve a quick and decisive victory. The U.S. and Iraq also go to war in the second scenario, but instead of lasting just weeks, the conflict drags on for nearly a half year. Of course, there is also a chance of a peaceful resolution to the conflict. This is explored in the third scenario.

The best place to start making comparisons is with the most likely, or baseline, scenario. Global Insight has assigned a 60% likelihood of occurrence to this scenario. A major assumption of this scenario is the war will begin in late January 2003 or early February and last four to six weeks. The cost of the war is put at $50 billion. The U.S. invasion of Iraq and the successful ouster of Saddam Hussein are expected to dominate first-quarter economic activity. A spike in oil prices and fear of possible setbacks with the ground war will drive consumer confidence and the stock market down at the beginning of the invasion. However, this should be short lived. Oil prices are expected to tumble once victory is assured. If the war last just a few weeks, the stock market and consumer confidence should bounce back quickly. This bounce should offset most of the mid-term hiatus. War-related Federal spending should surge, but primarily for activated reserves and combat pay. Spending to replace equipment and munitions are anticipated to kick in until the second half of 2003 and 2004.

There is the possibility the war may not go as smoothly for the U.S. This is covered in the second scenario, which has been assigned a 20% probability of occurrence. Conventional wisdom says that Saddam Hussein can be toppled and Iraq brought under control in a few weeks. While all objective criteria support this notion, there is at least some probability it will take several months to eliminate Saddam Hussein and stabilize the country. The scenario assumes the war drags on for nearly half a year. During this period, consumer confidence stays low, oil prices linger at inflated levels, business delay investment spending, and the stock market takes another tumble. The price tag for the war is $17 billion higher than in the baseline scenario, but the extra spending is sufficiently stretched out so it has no obvious impact on GDP growth. Consumer confidence is expected to improve once the war finally ends late in the second quarter of 2003. With inventories at bare-bones levels, production recovers over summer. By late summer, the economy should be on an upswing. In 2004, both consumers and businesses make up for lost time. Consumers flush with renewed confidence purchase vehicles and homes. Investment in equipment and software should soar. Federal spending is expected to stay high in 2004, as the government rebuilds war supplies and continues to build up homeland security.

In the third scenario, war is avoided. As a result, there is a lower fiscal injection from military spending than in the baseline. The economy does, however, get boosts from four other sources. First, oil prices are lower. Second, consumer confidence is higher. Third, the rebound in capital spending starts earlier than in the baseline scenario. Finally, growth abroad is higher, which boosts exports. This scenario also assumes fiscal and monetary policies achieve their intended goals. The anticipated early recovery of business spending provides the economy with a short-term boost. Additionally, it accelerates the nation's rate of capital accumulation, which raises the country's potential GDP. As a result, the economy can grow faster in the longer term without fueling inflation. In this scenario, the economy springs to life in 2003, posting four straight quarters of 3.8% growth. Admittedly, this is a very rosy scenario. It has a 20% probability of occurrence

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General Fund Update

As of December 31, 2002

Revenue Source	$ Millions FY03 Executive Estimate[3]	$ Millions DFM Predicted to Date	$ Millions Actual Accrued to Date
Individual Income tax	886.2	410.9	406.7
Corporate Income tax	86.0	43.1	41.8
Sales Tax	678.9	356.0	357.5
Product Taxes[1]	22.1	11.3	11.1
Miscellaneous	99.8	38.1	38.8
TOTAL GENERAL FUND[2]	**1,773.1**	**859.4**	**856.0**

1 Product Taxes include beer, wine, liquor, tobacco and cigarette taxes
2 May not total due to rounding
3 Revised Estimate as of January 2003

General Fund revenue experienced its first weakness of the 2003 fiscal year, coming in $3.4 million lower than expected in December. Both the Individual and Corporate Income Tax categories were below their December targets. Sales Tax receipts were actually slightly stronger than expected. It should be noted that December's result is based on a new General Fund revenue forecast that is $5.7 million higher than the previous forecast. Interestingly, an analysis done for the legislature's Joint Finance and Appropriation Committee indicates that under the previous forecast December revenue was actually $7.0 million short of expectations. This counterintuitive result is due to the fact that when the new revenue forecast is introduced in early January, the first five months of actual revenue is known, therefore predicted values are only applied to the period December through June. Actual revenue for the period July through November were $29.3 million higher than expected (under the previous forecast), so the current forecast requires less revenue in the period December through June than was predicted under the previous forecast.

Individual income tax revenue was $4.2 million lower than expected in December. On the receipts side filing payments were $2.4 million higher than expected and withholding payments were $2.9 million lower than expected, yielding a net shortage of $0.5 million. Refunds were $3.7 million higher than expected for the month.

Corporate income tax revenue was $1.3 million lower than expected in December. Filing payments were on target, but estimated payments were $3.2 million lower than expected for the month. Fortunately, refunds were also lower than expected in December (by $1.8 million), thereby mitigating a portion of the estimated payment shortage.

Sales tax revenue was $1.5 million higher than expected in December. This revenue reflects sales activity in November. Auto sales in November were essentially flat relative to a year earlier, so this major component of the sales tax likely did not contribute to December's strength. Extremely low interest rates have yielded incredible volumes of mortgage refinancing. This has increased disposable income, which is probably behind December's strong sales tax performance.

Product tax revenue were $0.2 million below target in December. Both the Cigarette Tax and Tobacco Tax were slightly lower than expected. Miscellaneous revenues were ahead by $0.7 million. Unclaimed property receipts were $1.1 million higher than expected, and were partially offset by Insurance Premium Tax payments that were $0.4 million lower than expected.